No. 13,006

IN THE

United States Court of Appeals

For the Ninth Circuit

ESTATE OF RALPH R. HUESMAN, DECEASED, NURMA W. HUESMAN, FRED B. HUESMAN, AND THE FARMERS & MERCHANTS NATIONAL BANK OF LOS ANGELES, EXECUTORS.
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Brief of Amici Curiae

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PRELIMINARY STATEMENT OF PURPOSE AND SCOPE OF BRIEF

Pursuant to leave of this Court, the undersigned attorneys file this brief as amici curiae. We represent the respondent (the petitioner in the court below) in the case of *Rose J. Linde v. Commissioner of Internal Revenue* (17 Tax Court No. 63). The Commissioner of Internal Revenue on or about March 14, 1952 filed with the Tax Court of

the United States a petition for review by this Court of the decision of the Tax Court in the *Linde* case.

One of the issues involved in the *Linde* case is also present in the instant case; namely, whether a deduction for income tax purposes under Section 162 of the Internal Revenue Code is available to amounts treated as gross income solely by reason of Section 126 of the Code. The position of the respondent in the *Linde* case, like that of the respondent in the instant case, is that the Tax Court correctly determined that such deduction is *not* available.

STATEMENT OF FACTS AND APPLICABLE STATUTES

The facts of this case may be briefly summarized as follows: At decedent's death, the sum of $80,517.00 was owed to him by his employer. The employer thereafter paid this amount to the executors of the estate. (It is conceded by both parties that this amount of $80,517.00 is includible in the gross income of the estate under the provisions of Section 126 of the Internal Revenue Code.) Pursuant to an order of the probate court, the executors of the estate then distributed this amount to the trustees of a trust esablished under decedent's will, and the trustees distributed this amount to the Loyola University, Regent's Fund, in partial satisfaction of its legacy under decedent's will. In its Federal income tax return for the fiscal year ended April 30, 1945, the estate reported the $80,517.00 as income of the estate under Section 126(a) of the Code, deducted $37,359.89 under Section 126(c) as the amount of estate tax attributable to the inclusion of the $80,517.00 item in the Federal estate tax return and deducted $80,517.00 under Section 162 of the Code. The claimed deductions

attributable to this $80,517.00 item thus totaled $117,876.89. The Commissioner allowed the deduction under Section 126(c) but reduced the amount to $36,514.30, and the estate does not contest this change. The Commissioner disallowed *in toto* the claimed deduction under Section 162 of the Code. On these facts, the Tax Court held that no deduction from gross income was allowable to the estate under Section 162 of the Internal Revenue Code by reason of the distribution of the sum of $80,517.00 to the University through the trustees.

The applicable provisions of the Statutes and the Regulations are set forth in the Brief for the Respondent (pages 19-29).

ARGUMENT

Petitioners Are Not Entitled to a Deduction of $80,517.00 for the Taxable Year 1945 Under Section 162(a) of the Internal Revenue Code.

The decision of the Tax Court is fully supported by the legislative history of Section 126. Prior to enactment of the Revenue Act of 1934, income accrued before death but received by the estate was not income to the estate but was corpus. Hence, it was not subject to income tax either to a decedent on the cash basis or to his estate. On the other hand, a decedent on the accrual basis would have paid income tax on such income as it accrued even though it was not received until after his death. Section 42 of the Revenue Act of 1934 required all income accrued up to the date of death, not otherwise properly includible for such period or a prior period, to be included in the income tax return of the decedent for the period in which fell the date of his death. This provision was enacted in order to avoid the discrimination in favor of cash-basis taxpayers and to

subject to income taxes amounts which would not otherwise be subject thereto, H. Rep. No. 704, 73d Cong., 2d Sess., p. 24 (1939-1 Cum. Bull. (Part 2) 554, 572); S. Rep. No. 558, 73d Cong., 2d Sess., p. 28 (1939-1 Cum. Bull. (Part 2) 586, 608).

However, hardship resulted in some instances under this provision as amounts which ordinarily would have been received by the decedent over a number of years were returnable in the year of death, thus carrying the income into higher brackets. To alleviate this harsh result, Section 126 of the Code was added by the Revenue Act of 1942 to provide that income accruing to a decedent by reason of his death was not includible in his final return but was to be treated as income by the one receiving the right to such income. This Section was enacted for the express purpose of relieving the hardship referred to above, while at the same time preventing the income involved from completely escaping income taxation (R. 136-138; H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 83-88 (1942-2 Cum. Bull. 372, 435-439); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 100-105 (1942-2 Cum. Bull. 504, 579-583)).

It was the intent of Congress in enacting Section 126 of the Code that amounts considered as gross income under that Section should in all respects be treated in the same manner in the hands of the estate (or other recipient) as they would have been treated in the hands of the decedent, had he collected such amounts. This is demonstrated by the following quotations from H. Rep. No. 2333 (1942-2 Cum. Bull. 372, 436-7), *supra:*

> "* * * This section changes the existing law by provision that *such amounts shall not be included in the*

*decedent's income but shall be treated, in the hands of the persons receiving them, as income of the same nature and to the same extent as such amounts would be income if the decedent remained alive and received such amounts * * * when his estate or his legatee takes his place with respect to this income, it is proper to continue to treat this right in their hands in the same manner as it would be treated in the hands of the decedent.*

* * * * * * *

"All amounts of gross income which are not includible in the income of the decedent will, when received, be includible in the income of the person receiving such amounts by inheritance or survivorship from the decedent under section 126, to be added to the Code by subsection (e) of this section. The persons who are placed, with respect to such amounts, *in the same position as the decedent are the decedent's estate,* which in the great majority of cases will be the one who receives such amounts, and, if the estate does not collect such amounts but distributes the right to receive such amounts to the heir, next of kin, legatee, or devisee, who inherited or was bequeathed or devised such right, such heir, next of kin, legatee, or devisee. * * *

"Since this section provides for the treatment of such amounts as income to the persons *placed in the same position as the decedent with respect to such amounts,* the provisions of section 113(a)(5) with respect to the basis of property do not apply to these amounts in their hands. Furthermore, section 126 only applies to the amount of items of gross income in respect of a decedent, and items which are excluded from gross income with respect to the decedent under section 22(b) or section 116 are not within the provisions of section 126.

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"Subsection (a)(3) of section 125 provides that the right to receive an amount described in subsection (a)(1) shall be *treated in the hands of a person described in that subsection as if it had been acquired in the transaction by which the decedent acquired such right, and shall be considered as having the same character it would have had if the decedent had lived and had received such amount. This provision is designed to place the person described in subsection (a)(1) in the same position with respect to the nature of this income as the position the decedent enjoyed.* Thus, if the income to the decedent would have been capital gain from the sale of property, if he had lived and had received it, the income when received, or its fair market value if transferred, shall be treated in the hands of the person described in (a)(1) as capital gain from the sale of the property, in the same manner as if such person had held the property for the period the decedent held it, and had made the sale. Similarly, if the income is interest on United States obligations owned by the decedent, such income shall be treated for the purpose of determining the credit provided by section 25(a)(1) and (2) in the hands of the person receiving it as interest from United States obligations, as if such person owned the obligations with respect to which such interest is paid. If the amounts would have constituted earned income to the decedent, such amounts shall constitute earned income to the person including such amounts in his gross income to the same extent as if he had engaged in place of the decedent in the transaction in which the amounts were earned. If the amounts are compensation for personal services rendered over a period of 36 months, and would be within the provisions of section 107 if the

> decedent lived and included such amounts in his gross income, section 107 applies. That is, the tax of the person including this amount in gross income attributable to the inclusion of such amount in his income shall not exceed the aggregate of the taxes of the decedent which would be attributable to such amount if it had been received by the decedent in equal portions in each of the months included in the period in which the personal services were rendered. * * *"
> [Italics supplied.]

Nearly identical language is contained in S. Rep. No. 1631, *supra,* and similar provisions are included in the Commissioner's regulations, Treasury Regulations 111, Section 29.126-1 (quoted in the Brief for Respondent, pages 25-9).

Had the decedent himself lived to receive the $80,517.00, he would not have been permitted the unlimited charitable deduction of Section 162(a), as that deduction is by its specific terms limited to trusts and estates. Under petitioners' theory, the unlimited charitable deduction would be permitted to the estate even though it would have been denied to decedent in his lifetime. This interpretation frustrates the clearly expressed Congressional intent regarding Section 126 and should therefore be rejected.

If any of the number of sections of the Internal Revenue Code expressed in general terms are literally applied to amounts treated as income under the specific provisions of Section 126 (as petitioners are attempting to apply Section 162(a)), without taking into account the basic purpose behind Section 126, results obviously unintended by Congress will ensue. For example, let us assume that certain amounts constituting gross income under Section 126 are

received by an estate, that such amounts were attributable to the personal services of a decedent and had he received such amounts they would have qualified for special treatment under Section 107 of the Code. Attempting to apply the wording of Section 107 literally to such a case, without taking into account the basic purpose of Section 126, would result in the denial of the benefits of Section 107 to such amounts, since Section 107 applies only to amounts "received or accrued * * * by an individual or a partnership," and the estate is not an individual or a partnership. Likewise, it might be argued that interest on certain United States obligations received by an estate and constituting gross income under Section 126 could not qualify for the normal tax credit provided by Section 25(a) of the Code since such interest is not included in gross income under Section 22 of the Code (a prerequisite to the credit under Section 25) but is included in gross income under Section 126 of the Code. Yet the Committee Report quoted above clearly shows that in both of these cases the estate or other person receiving the income to which Section 126 applies is entitled to the same benefits and is to be treated in the same manner as if the amounts in question had been received by the decedent himself rather than by the estate or heir.

The examples given in the reports quoted above are obviously not intended to be exclusive; they are merely general examples of the basic premise that Section 126 "is designed to place the person described in subsection (a)(1) in the same position with respect to the nature of this income as the position the decedent enjoyed." Petitioners seek to place the estate in a more favorable position than

that which would have been enjoyed by the decedent in that it would afford to the estate benefits of Section 162(a) for which the decedent could not have qualified.

The petitioners' contention that Section 162(a) applies to amounts considered as gross income under Section 126 should be rejected for the additional reason that its adoption would permit a double deduction to decedents (such as the instant decedent) reporting on the cash basis and would discriminate against the estates and heirs of decedents who had reported their income on the accrual basis. Under petitioners' theory, the estate in the instant case would include in its gross income for the taxable year 1945 the amount of $80,517.00. The estate would be allowed a deduction under Section 126(c) of the $36,514.30 in estate taxes attributable to the inclusion of this item in the Federal estate tax return (R. 31-2), and in addition would be allowed a deduction under Section 162(a) of the Code of the entire amount of $80,517.00 paid over to the University. Thus, the estate would be allowed deductions aggregating $117,031.30 because of including an item of income of $80,517.00. This deduction would, of course, not only completely offset the income included under Section 126 but would also offset a great deal of the regular income of the estate. Before enactment of Section 126, the estate would not have included the $80,517.00 in its income; however, it would have been entitled neither to the $80,517.00 deduction claimed under Section 162(a) nor to the deduction of $36,514.30 allowed under Section 126(c). Thus, under the construction urged by petitioners, the net effect of Section 126 in the instant case would be to increase the gross income of the estate by $80,517.00 and to increase its

deductions by $117,031.30. Section 126, which was intended by Congress to tax to estates and heirs, income in respect of decedents which otherwise would have escaped taxation, would, under petitioners' theory, *reduce* the taxable income of the estate by the amount of $36,514.30! Certainly this bizarre result was not intended by Congress.

The fact that under petitioners' theory there would be double deductions is, of itself, sufficient to warrant its rejection. Double deductions are not permitted under the income tax laws. Treasury Regulations 111, Section 29.23(a)-1 states:

> "* * * Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. * * *"

The same provisions occur in Regulations 111, Section 29.23(a)-15(*c*).

To appreciate more fully the consequences of the adoption of petitioners' argument, we should consider what would have happened had the decedent in the instant case reported his income on the accrual basis. In that event, he would have reported this amount of $80,517.00 in his income for a year or years prior to his death and would have paid income taxes thereon, without the benefits of Section 162(a). At his death, the amount of $80,517.00 (offset in part by the income taxes payable thereon) would have been includible in the decedent's estate for Federal estate tax purposes. When the $80,517.00 was actually paid to and received by the estate, it would not constitute income to the estate under Section 126 at all, nor would there be any deduction under Section 126(c). There would be no deduction under

Section 162(a) in case of a distribution to a charity, since the amount in question would constitute gross income of the estate neither under Section 126 nor otherwise. Thus, under petitioners' theory, had the decedent in the instant case reported his income on the accrual basis, he would have included in his income during his lifetime the amount of $80,517.00 and paid income taxes thereon. However, by being on the cash basis, he escapes paying income tax on this amount during his lifetime and his estate is not only freed from any income tax liability with respect to this amount but actually is enabled to reduce its taxable income by $36,514.30 by reason of Section 126.

Petitioners thus interpret Section 126 not as subjecting to income tax income which would otherwise have escaped taxation, but as granting to such income a double deduction. They interpret that section not as removing the discrimination against accrual basis taxpayers and in favor of cash basis taxpayers, but rather as increasing this discrimination. The construction of that section by the Tax Court in this case, on the other hand, carries out the express intent of Congress that income of the type involved here be taxed to the estate or to the other person receiving it and effectively removes the discrimination between cash basis and accrual basis taxpayers which was present under the old law.

Petitioners place their main reliance upon *Boston Safe Deposit & Trust Co. v. United States* (D.C. Mass., 1948) 75 F. Supp. 884 (Appellants' Opening Brief, page 12 and Appendix). However, that case is clearly not in point. The *Boston Safe Deposit* case involved income *earned by the estate* after decedent's death rather than income earned

by the decedent and treated as income to the estate solely by reason of Section 126 of the Code.

In that case, the decedent had been a member of a partnership during his lifetime and after his death, his executors under an arrangement with the other partners became a partner and received certain portions of the partnership earnings. The executors distributed these earnings to the trustees of a trust created under decedent's will under an order of the probate court which referred to them as principal and not as income. It was held that the amounts thus paid constituted income of the estate and that the estate was entitled to a deduction under Section 162 of the amounts distributed to the trustees.

The *Boston Safe Deposit* case merely holds that a deduction under Section 162 is allowable for distributions of income *earned by the estate* after the decedent's death; it is not authority for the double deduction claimed by the petitioners in the instant case and is not authority for the discrimination against accrual basis taxpayers that would result from adoption of petitioners' construction of Section 162.

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Respectfully submitted,

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